Estate of Mollie P. Fabric, Elliot Fabric, Personal Representative, Petitioner v. Commissioner of Internal Revenue, Respondent, 83 T. C. 932 (1984)

A valid annuity agreement, supported by adequate consideration, can exclude transferred assets from a decedent's gross estate.

Summary

In Estate of Fabric v. Commissioner, the Tax Court ruled that Mollie P. Fabric's transfer of assets to a foreign trust in exchange for a lifetime annuity was a valid annuity agreement, not a retained life estate. The court found that the annuity's value, calculated using actuarial tables, was adequate consideration for the transferred assets. Consequently, these assets were excluded from Fabric's estate. This decision hinges on the distinction between a true annuity and a retained life interest, guided by Ninth Circuit precedents that emphasize the formal terms of the annuity agreement over informalities in administration.

Facts

Five days before undergoing open-heart surgery, Mollie P. Fabric created an irrevocable foreign trust (Chai Trust) with an initial funding of $750. She entered into an annuity agreement with the trust, promising to transfer assets worth $1,150,000 in exchange for weekly payments of $2,378. 48 for life. The annuity amount was determined using actuarial tables and was not dependent on the trust's income. The trust's beneficiaries were Fabric's four sons and their descendants. Fabric survived the surgery by 1 year and 5 months, and her estate did not report the transferred assets as taxable.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency, claiming the transferred assets should be included in Fabric's estate, either as a transfer in contemplation of death or as a retained life estate. The Estate appealed to the Tax Court, which, bound by Ninth Circuit precedent, ruled in favor of the Estate, finding a valid annuity agreement.

Issue(s)

1. Whether Mollie P. Fabric entered into a valid annuity agreement with the Chai Trust, or if she retained a life estate in the transferred properties.
2. If a valid annuity existed, whether adequate and full consideration was given for the annuity.

Holding

1. Yes, because the terms of the annuity agreement were binding and the trust did not act merely as a conduit for income distribution, following Ninth Circuit

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precedents in La Fargue and Stern.
2. Yes, because the annuity was properly valued using actuarial tables, and the consideration given was adequate and full.

Court’s Reasoning

The court applied Ninth Circuit decisions in La Fargue and Stern, which emphasized the formal terms of annuity agreements over informalities in trust administration. The court found that the annuity payments were fixed and not tied to the trust’s income, distinguishing it from cases where the trust acted as a conduit for income. The court also ruled that the use of actuarial tables to value the annuity was appropriate, as Fabric’s life expectancy was not clearly imminent or predictable at the time of the agreement. The court rejected the Commissioner’s arguments that informalities in trust administration invalidated the annuity, and found that the actuarial tables’ use was justified, supported by expert testimony that the consideration was adequate.

Practical Implications

This decision reinforces the validity of annuity agreements in estate planning, particularly when structured with independent trustees and fixed payments not tied to trust income. Practitioners should ensure that annuity agreements are meticulously documented and administered to withstand scrutiny, focusing on the formal terms rather than minor administrative irregularities. The ruling also underscores the importance of using actuarial tables for valuation unless there is clear evidence of imminent death. This case may influence how future estate planning strategies utilize annuities to exclude assets from taxable estates, and how courts assess the validity of such arrangements based on Ninth Circuit standards.

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